

This letter discusses nexus and Service Occupation Tax issues related to sales of medical appliances from outside the State. See 86 Ill. Adm. Code 150.201. (This is a GIL).

June 10, 2002

Dear Xxxxx:

This letter is in response to your letter dated March 18, 2002 and our telephone conversation of May 31, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

At this time, I am requesting a letter ruling from the Illinois Department of Revenue dealing with the Retailer's Occupation Tax vs. Use Tax. Following is a brief outline of our business activities followed by the tax issues needing resolution.

Background Information:

AAA operates retail optical departments in 46 states along with ophthalmic laboratories in 3 states, which produces the prescription eyewear for the retail departments.

In the state of Illinois AAA operates retail optical departments providing eye exams by a Doctor of Optometry, filling of prescriptions and fitting of eyeglasses by an optician. The optician forwards the Rx (prescription) to our satellite lab, which is located outside the state of Illinois for filling.

On our customer's receipt, the eye examination is separately stated. Also, there is no charge to the customer for filling their Rx however, there may be a dispensing fee for fitting/dispensing the eyewear, which is also separately stated on their receipt. Tax is charged at the reduced drug/medical appliance rate on the dispensing fee and the selling price of the Rx. The reduced drug/medical appliance rate charged is that of the city, town, or village where the retail optical department is located. AAA is registered with the state of Illinois and collects & remits tax under the consolidated ###.

Additional Commerce Activity:

AAA is about to embark on additional commerce over the Internet. Contact lenses will be offered for sale using a web server located outside the state of Illinois. The contact lenses would be shipped from a location outside the state of Illinois to customers located within the state of Illinois. Lenses will be shipped directly to the customer using

either AIRBORNE or US Mail Service. Contact lenses sold over the Internet may be returned to any of our retail locations within the state of Illinois.

Issues:

Are the web sales of contact lenses subject to Illinois Use Tax or are they subject to Illinois Retailers' Occupation Tax? What tax rate is applicable under either tax scenario?

I respectfully request a letter ruling on the above stated issues including sites of Illinois law along with complete explanations. SSS endeavors to comply with the tax laws of the various states and from time to time requires their timely assistance in doing so. Your attention and assistance with this request will be very much appreciated.

If there is any additional information required, please contact me either at the above address or by telephone.

Whether a retailer is subject to Illinois Retailers' Occupation Tax liability or is required to collect Illinois Use Tax from its Illinois customers depends upon the retailer's activities in Illinois.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i), enclosed. This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, enclosed. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax law. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to *Brown's Furniture, Inc. v. Wagner*, 171 Ill.2d 410 (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the

out-of-State goods and have a duty to self-assess their Use Tax liability, and the customer must remit the amount directly to the State.

In general, the imposition of the various local sales taxes in Illinois takes effect when “selling occurs in a jurisdiction imposing a tax. The Department’s opinion is that the most important element of selling is the seller’s acceptance of the purchase order. Consequently, if a purchase order is accepted in a jurisdiction that imposes a local tax, that tax will be incurred. See 86 Ill. Adm. Code 270.115(b), enclosed. The tax rate is fixed by the location of the seller, not the delivery location. The fact that the item being sold is shipped from out-of-State or from another Illinois location is immaterial for purposes of local taxes if the sale occurs through order acceptance in an Illinois jurisdiction imposing a local tax. For these transactions the local tax will be incurred.

If a purchase order is accepted outside the State, but the property being sold is located in an inventory of the retailer that is located in an Illinois jurisdiction that has imposed a local tax, then the location of the property at the time of sale will determine where the seller is engaged in business for the purpose of determining the imposition of applicable local sales taxes. In situations in which the retailer has nexus, but both the purchase order acceptance and the location of the property being purchased are outside the State of Illinois, such sales would only be subject to the Illinois Use Tax at the rate of 6.25%.

Based upon the information provided, it appears that your business has nexus with Illinois such that it must collect tax on sales that are made over the Internet to Illinois residents. However, it is important to note that businesses that engage in filling prescriptions for eyeglasses and contact lenses are subject to the Service Occupation Tax Act and Service Use Tax Act, not the Retailers’ Occupation Tax Act and Use Tax Act.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen use to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers’ Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred.

If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers’ Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal

property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers. See 86 Ill. Adm. Code 140.108.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. See 86 Ill. Adm. Code 140.109.

As you are aware, qualifying medicines and medical appliances are taxed at the lower rate of 1%, plus applicable local taxes. See the enclosed copy of 86 Ill. Adm. Code 130.310. A medical appliance is defined as an item intended by its manufacturer for use in directly substituting for a malfunctioning part of the body. Examples of items that qualify are artificial limbs, dental prostheses, and heart pacemakers. Corrective medical appliances such as eyeglasses and contact lenses are also examples of qualifying items.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Martha P. Mote  
Associate Counsel

MPM:msk  
Enc.